



April 8, 2008

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, DC 20551

RE: Comments on Docket No. R-1305; Regulation Z (HOEPA)

Dear Ms. Johnson:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents the interests of our nation's federal credit unions (FCUs), I am writing in response to the Board of Governors of the Federal Reserve System's (Board) request for comment on the proposed amendments to Regulation Z pursuant to the Board's authority under the Home Ownership and Equity Protection Act (HOEPA). The proposed amendments would prohibit certain unfair, abusive or deceptive practices in connection with closed-end mortgage loans.

Specifically, the proposed rule would create seven new protections or restrictions for mortgage lending, some which would apply only to "higher-priced mortgage loans," and others applying to all mortgage loans secured by a consumer's principal dwelling. Additionally, the proposal would modify the disclosure requirements for mortgage advertisements and revise the timing requirements for providing disclosures for closed-end mortgages.

Particularly in light of the current crisis in the subprime mortgage market, NAFCU commends the Board's action to put forward a regulatory solution to prevent certain unscrupulous mortgage practices that contributed to the rapidly rising delinquencies and record-high wave of foreclosures being seen today.

While we have some concerns about certain aspects of the Board's proposal and the increased regulatory burden it imposes, NAFCU is generally supportive of the proposed rule. In the spirit of "people helping people," credit unions have always honored their original mission of serving the provident credit needs of their members. NAFCU and the credit union community firmly believe that consumers must be protected from predatory and deceptive lending practices. Nevertheless, it is imperative that access to responsible credit be preserved to ensure that affordable credit is available to those underserved individuals who are most in need of financial services. Toward that end, NAFCU offers the following specific comments.

“Higher-Priced Mortgage Loans”

The proposal would establish a new category of “higher-priced mortgage loans,” which would include closed-end mortgage loans having an annual percentage rate (APR) that exceeds the rate on a comparable Treasury security by three or more percentage points for first-lien loans, or five or more percentage points for subordinate-lien loans. These proposed thresholds are intended to capture the subprime market but exclude the prime market. The Board has requested comment on whether the proposed thresholds would satisfy this objective.

NAFCU believes it is imperative that the definition of “higher-priced mortgage loan” be narrowly tailored to the subprime market in order to avoid any adverse impact on the cost and availability of credit in the prime or near-prime (or “Alt-A”) markets. Very few credit unions have been involved in “subprime” mortgage lending. Those that do engage in the practice use it as a tool to assist borrowers with credit problems and to help consumers rebuild their credit worthiness. Indeed, the Federal Reserve Board’s data demonstrates that the percentage of credit union mortgage loans above the Treasury benchmark is very small. For example, according to 2006 Home Mortgage Disclosure Act (HMDA) data, only 2.8 percent of all credit union loans and only 3.1 percent of minority loans are non-prime.

NAFCU agrees with the Board’s determination that “substantive restrictions on loan terms or lending practices are [not] warranted in the prime market at this time. The need for such restrictions is not clear and their potential unintended consequences could be significant.” 73 Fed. Reg. 1683 (January 9, 2008). Moreover, NAFCU believes that the proposed thresholds are too low to effectively exclude the prime market and may create unintended consequences at a time when liquidity in the market for affordable mortgage loans is so crucial. Accordingly, NAFCU recommends that the thresholds be raised to at least five and seven percentage points, respectively, to avoid any unintended adverse impact on liquidity and affordability in the prime or near-prime mortgage market.

Prohibition Provision Regarding Repayment Ability

The proposal would prohibit creditors from engaging in a pattern or practice of extending credit to a consumer without regard to the consumer’s repayment ability, and create a rebuttable presumption that the rule has been violated where a creditor engages in a pattern or practice of failing to consider certain factors, including debt-to-income ratio and the ability to make fully amortizing payments including taxes and insurance.

NAFCU strongly believes credit unions should carefully manage risk exposures when participating in subprime lending activities. Toward this end, it is imperative that credit unions conduct a careful and credible analysis of borrowers’ repayment capacity. Accordingly, NAFCU generally supports the approach taken by the Board and the other financial regulators in the *Interagency Guidance on Nontraditional Mortgage Product Risks*, 71 Fed. Reg. 58609 (October 4, 2006), and the *Statement on Subprime Mortgage Lending*, 72 Fed. Reg. 37569 (July 10, 2007) (FFIEC Mortgage Guidance). However, NAFCU maintains that while the basic tenets of the FFIEC Mortgage Guidance articulates sound, broad-based underwriting principles that might be considered in underwriting, we do not believe that these principles should be imposed on federal depository institutions via regulation. Likewise, NAFCU does not support the regulatory codification of a

repayment ability standard via the proposed prohibition against a pattern or practice of extending credit without regard to repayment ability.

Should the Board determine to move forward with its proposal however, NAFCU strongly urges the Board to retain the proposed “pattern or practice” element in the final rule. In our opinion, the Board’s assessment that “creating civil liability for an originator that fails to assess repayment ability on any individual loan could inadvertently cause an unwarranted reduction in the availability of mortgage credit to consumers,” is correct. 73 Fed. Reg. 1688 (January 9, 2008). NAFCU believes that if the “pattern or practice” element is removed from the prohibition, the threat of litigation may force lenders to price for this increased risk, thereby raising the cost of credit and creating indirect harms for consumers. This is particularly true in the case of federal credit unions because, as member-owned not-for-profit cooperatives, any adverse economic impact on a credit union is ultimately felt by its members.

Safe Harbor

Under the proposal, safe harbor for compliance with the prohibition provision regarding repayment ability would be provided for creditors with a reasonable basis to believe that the borrower will be able to make loan payments for at least seven years after consummation of the loan.

NAFCU appreciates the inclusion of the safe harbor provision and generally believes that the assurance of safe harbor is helpful to assist lenders in compliance. However, we feel that the proposed seven-year time period is unreasonable. By comparison, underwriting requirements for FHA loans require borrowers’ income to be verified as reasonably “expected to continue” for the first three years of the mortgage. Similarly, secondary market guidelines require continuance of only three years. As such, NAFCU recommends a three year future term of a borrower’s ability to repay for the purposes of safe harbor.

Documentation of Income

NAFCU believes that when credit unions are faced with loan characteristics that create a higher level of risk, it is important for lenders to take prudent steps to ensure that income information is accurate and verifiable in order to fully mitigate the added risk inherent to subprime and higher-risk loans.

However, we believe there are circumstances where a reliance on stated income may be appropriate. For example, NAFCU maintains that reduced documentation should be available for well-qualified borrowers. For financially sophisticated borrowers with higher credit scores, stated income or no doc loans can be beneficial in providing greater flexibility and the added convenience of an expedited origination process. Further, in circumstances where the credit union offers risk-based pricing, in which the borrower’s employment history, credit history, etc. are considered, it may be suitable to rely on stated income in underwriting a loan.

NAFCU is generally supportive of the requirement that creditors verify the income and assets they rely on in making a loan determination. We are concerned, however, that the rule, as proposed, lacks sufficient flexibility and may impose an unnecessary regulatory burden on credit unions. As such, NAFCU recommends that the Board clarify that the types of third-party documentation that are

enumerated in the proposed rule (i.e., IRS W-2s, tax returns, payroll receipts, financial institution records) are merely illustrative, and that the lender has the discretion to determine its own policy regarding the types of documentation that would be acceptable to verify a borrower's income. NAFCU also believes that subordinate-lien loans should be exempted from the income verification requirements in order to provide greater flexibility to lenders.

Prepayment Penalties

Regulation Z currently prohibits prepayment penalties for HOEPA loans, unless certain conditions are met. The Board's proposal would extend this prohibition (and its exceptions) to higher-priced mortgage loans. Additionally, for both higher-priced mortgage loans and HOEPA loans, any permissible prepayment penalty must expire at least sixty days before the date of the first principal or interest payment increase, if any.

NAFCU believes that prepayment penalties are often utilized in an inappropriate manner and should generally be prohibited. Excessive prepayment penalties discourage—and often prevent—borrowers from refinancing or selling their homes and significantly undermine consumer choice. Federal credit unions are already prohibited from imposing prepayment penalties. 12 U.S.C. §1757(5)(A)(viii); 12 CFR 701.21. Banning prepayment penalties for all lenders would not only level the playing field, but remove any incentive for unscrupulous lenders to entice consumers with lower up-front costs, only to impose unaffordable prepayment penalties on the back end when the borrower later wishes to relocate or refinance their loan to receive more favorable terms or to avoid payment shock when the rate resets.

For these reasons and more, NAFCU agrees with the proposed prohibition on prepayment penalties. Furthermore, we recommend that the exceptions to the prohibition be eliminated for both higher-priced mortgage loans and HOEPA loans.

Mandatory Escrows

In general, NAFCU believes that escrows for taxes and insurance benefit both lenders and borrowers. Requiring escrow for subprime loans is prudent to protect the lender's asset. Additionally, escrows for taxes and insurance help to ensure that subprime borrowers, who often lack knowledge or experience with financial management, budget effectively for these costs. Nevertheless, NAFCU believes that it is ultimately the consumer's prerogative whether to escrow and we do not feel that mandatory escrows should be required for higher-priced mortgage loans. If at all, mandatory escrows should be required only for HOEPA loans, but not higher-priced loans. Escrow accounts would be costly to establish for some credit unions, particularly smaller institutions. Thus, NAFCU encourages lenders to establish escrows for subprime loans but does not believe mandatory escrows should be required by regulation.

However, should mandatory escrows be mandated for higher-priced and HOEPA loans in the final rule, NAFCU believes the Board should consider establishing exceptions for certain loans with a low loan-to-value (LTV) ratio and in other appropriate circumstances. For example, current secondary market guidelines allow for a waiver of escrow for loans with an LTV ratio that is less than or equal to 80 percent. Additionally, it is our opinion that consumers should be given the opportunity to opt-out of mandatory escrows 12 months after loan consummation.

All Closed-End Mortgage Loans

For all closed-end mortgage loans secured by a consumer's principal dwelling, the proposal would provide for new rules regarding: (1) creditor payments to mortgage brokers, including yield spread premiums; (2) appraiser coercion; and (3) loan servicing practices. The proposal would also amend the timing requirement for existing "early" disclosures. NAFCU generally agrees with the proposed provisions applying to all closed-end mortgage loans.

Advertising Disclosures and Prohibited Practices

NAFCU is strongly supportive of the proposed advertising provisions, which would modify the disclosure requirements for mortgage advertisements and prohibit creditors from engaging in certain misleading and deceptive advertising practices. While we emphasize that credit unions do not engage in deceptive advertising practices, NAFCU is aware of abuses occurring in the marketplace, particularly with respect to deceptive uses of the term "fixed," and misleading promotions of introductory "teaser" rates. As such, NAFCU agrees that the proposed advertisement provisions are prudent in order to ensure that consumers are fully informed of the true terms of credit. These provisions should also be extended to advertisements for home equity plans.

Effective Date

The Board has specifically solicited comment on whether a six month period is sufficient for creditors to implement the proposed rule, or whether a delayed effective date should be established.

NAFCU does not believe that six months is sufficient time for credit unions to fully implement and comply with the proposed changes. Compliance will require lenders to revise policies, conduct staff training, and modify disclosures. Additionally, many credit unions will need sufficient time to establish escrow accounts, should mandatory escrows be required in the final rule. Accordingly, NAFCU recommends that a minimum of 12 months be provided to allow credit unions with adequate time to implement the new rule.

NAFCU appreciates the opportunity to comment on this proposed rulemaking. Should you have any questions or require additional information please call me or Pamela Yu, NAFCU's Associate Director of Regulatory Affairs at (703) 522-4770 or (800) 336-4644 ext. 218.

Sincerely,



B. Dan Berger
Senior Vice President of Government Affairs

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